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Frugality among consumers is outliving recession

Economy could be hobbled for a while by penny-pinchers

By Jeannine Aversa and Bernard Condon

Even as the economic recovery plods ahead, many American consumers are refusing to come along.

They're not spending freely — and they have no plans to.

Many of them have steady income. They aren't saddled by high debts. They don't fear losing their jobs. Yet despite recent gains, they've lost so much household wealth that they're far more cautious about spending than before the recession.

Their behavior suggests that the Great Recession may have bred a new frugality that will endure well into the recovery. And because consumers fuel about 70 percent of the economy, their tightfisted habits means the rebound could stay unusually sluggish.

That's the picture that emerges from an Associated Press survey of leading economists and interviews with more than two dozen ordinary Americans. The new AP Economy Survey asked 44 leading economists whether the recession created a "new frugality" among consumers that will outlive the recession. Two-thirds said yes.

They had in mind people like Marjorie Feldman of suburban St. Louis, who retired three years ago as a systems analyst for a utility company. The stock investments in her retirement account have sunk 15 percent from 2007. The value of her home is down 20 percent.

"I had retired assuming I'd make money" off the investments, said Feldman, who's in her early 60s. "I just don't feel as confident in the economy, and I never will again. I won't spend money the way I used to."

Feldman's husband works full time in academia. She has a part-time job preparing tax returns at H&R Block. But her prime earning years are behind her.

"I don't think it will ever get back to where it was before," she said of her nest egg. "I won't spend money the way I used to."

Scott Hoyt, senior director of consumer economics at Moody's Economy.com, notes that Baby Boomers, in particular, enjoyed spending sprees for most of their adult lives as their assets steadily grew.

"But the recession changed that," Hoyt said. "Many have retirement and children's education looming. All of a sudden, they see their balance sheets decline in a way they've never seen before."

To be sure, many shoppers, especially the wealthy, are buying into the recovery. Partly on the strength of consumer spending, the economy emerged from recession last year and has been growing steadily, if moderately, since. Major retailers logged solid sales in March. Employers have begun to add jobs, including a net increase of 162,000 in March. The stock market has risen 70 percent from its low in March 2009.

Yet many who became penny-pinchers during the recession are in no mood to start shopping again with abandon for clothes, cars and home additions. They've discovered the peace of mind that comes with rebuilding savings, shopping more prudently and learning to live with less.

At their nerve-racked peak last year, Americans socked away 6.4 percent of their disposable income. That compared with less than 1 percent hit at one point during the pre-recession boom. The savings rate has since dropped to 3.1 percent. Yet few expect it to approach the near-zero savings rate that would signal high-octane spending has roared back.

Susan Wilson, 55, a freelance PR specialist in Scottsdale, Ariz., says her business is picking up. But her spending isn't. Wilson still feels burned by the recession, when she lost her home to foreclosure.

"Shame on me," she said. "I wasn't paying enough attention to my financial health. That will never happen again."

Wilson is renting now. She traded in her leased car for a used car she could buy outright. She's started growing her own vegetables and air-drying her laundry to save money and stay out of debt. She's looking to buy a home, but not one with an outsize mortgage.

"I'm looking for pretty much the smallest house I can live in," she said.

Interviews with ordinary Americans suggest a new frugality endures even though consumer spending has risen for five straight months and retail sales for three.

In the AP's new quarterly survey, a majority of economists agreed that a new frugality will persist even as the recovery gains firmer footing.

"I would call it a 'mini age of austerity,'" said Sean Snaith, an economics professor at the University of Central Florida.

"Consumers will not run up multiple credit cards to their limits, and when buying a house the objective will not be to get the maximum square footage for which they can afford the payment. A higher savings rate will be in place for several years."

Jeff Thredgold, an economist at Thredgold Economic Associates, predicts "less impress-my-neighbor-type spending" in coming years.

Count Keith Flowers of Manassas, Va., in that category. He's decided that the hit he took in the housing slump requires him to continue to rein in spending. He's cut off his landline phone and has become a regular at discount retailer Costco.

He isn't worried about losing his job in business development at an information technology company. What's led him to cut back spending is the sunken value of his condominium. He bought it in 2005 for about $270,000.

"I doubt right now it's cracking $100,000," Flowers said.

Rajeev Dhawan, director of Georgia State University's Economic Forecasting Center, says: "I think the chances of us being big spenders in the next 10 years are pretty low."

So much household wealth was inflated by the housing boom, Dhawan said, that the real estate bust spooked consumers. States hardest hit by the bust — California, Nevada, Florida and Arizona — together account for about 30 percent of national economic activity, he noted.

Household net worth — the value of assets like homes, checking accounts and investments minus debts like mortgages and credit cards — has risen for three straight quarters. But economists say consumers would need a stronger and prolonged increase in wealth to lead them to ratchet up spending. Net worth would have to rise an additional 21 percent just to get back to its pre-recession peak of $65.9 trillion.

Some economists put their hopes for the economy in the rich, who are spending more freely than the rest of the population. They hold out hope that this will encourage more hiring and stimulate spending by the less wealthy. More spending could increase companies' revenue, which allow them to boost hiring and pay. And that would lead their employees to spend more.

Royal Caribbean Cruises Ltd. returned to a first-quarter profit as more travelers vacationed on its ships and spent more money on board. And makers of luxury goods are benefiting from a release of pent-up demand for jewelry, watches and high-end furnishings.

High-end retailers have reported blowout results. Nordstrom's revenue in stores open at least one year jumped 16.8 percent last month. Saks' surged 12.7 percent.

McClaren Automotive has announced it will debut a $200,000 sports car in the U.S. next year. And business is picking up faster at high-end hotels than at mid-priced and budget hotels.

Whether spending by the wealthy will cause the less-well-off to spend freely, too, remains unclear. For now, though, many people have embraced a more frugal approach to spending.

Or maybe they've just learned to go without.

Jan Iris Smith, 57, and her husband of Cabin John, Md., put off furniture and clothing purchases after the stock market's collapse in early 2009.

"We were counting on our income from our investments," said Smith, a psychotherapist whose husband is retired. "We just stopped pretending everything was going to be OK anytime soon."